United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

74-1279

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No. 74-1279

JORDAN BROWN and all others similarly situated,

Plaintiff-Appellee

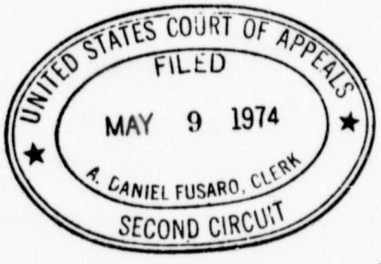
against

FIRST NATIONAL CITY BANK,

Defendant-Appellant

ON APPEAL from the UNITED STATES DISTRICT COURT for the SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR PLAINTIFF-APPELLEE



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Preliminary Statement

Plaintiff-Appellee submits this brief in opposition to the appeal of defendant and in support of his cross-appeal from so much of decretal paragraph (4) of the order of Hon. Kevin Thomas Duffy, Jr., dated January 28, 1974, as grants summary judgment to defendant and denies injunctive relief to plaintiff, with respect to defendant's practice of failing to deduct deposits to checking accounts from outstanding Checking Plus loans. The decision upon which this order is based is reported at 365 F.S. 1286.

Issues Presented for Review

1. Is a statute (108(5)(a), which permits agreements pursuant to which loans may be made by honoring overdraft checks, violated by using a practice which compels loans in amounts greater than necessary to honor the overdrafts?

2. Is a statute (108(5)(b()i), which requires that interest be computed on the "unpaid principal amount" of a loan, violated by using a practice which fails to deduct payments made by deposits to a checking account which has overdraft loans outstanding?

3. Is a statute (108(5),subds.(d),(e) & (f), which carefully restricts all charges and expenses and devices and schemes to circumvent its intent, violated by the $100 multiple practice and the failure to deduct deposit payments by defendant?

4. Are the $100 multiple practice and failing to deduct deposit payments, devices that are unconscionable, unequitable and lacking in good faith?

Statement of the Case

A. Nature of the Case

This is a class action challenging as usurious various methods of computing interest charges utilized by defendant Citibank in connection

with Checking Plus loan accounts of checking account customers.

This action seeks declaratory, injunctive and monetary relief. It is based upon: (a) violations of the National Bank Act (12 U.S.C. Secs. 85 and 86) and the N.Y. Banking Law, Sec. 108, subd. 5 (hereinafter 108(5) (Count I); (b) breach of contract (Count II); (c) money had and received (Count II); and (d) unjust enrichment (Count IV).

B. Proceedings Below

The defendant answered the complaint and then moved for summary judgment dismissing the complaint in its entirety. The plaintiff cross-moved for summary judgment as to Counts I, III and IV of the complaint, with respect to two specific practices of defendant, to wit, (1) imposing interest charges on amounts which are in arbitrary multiples of $100, rather than on the actual amount of check overdrafts; and (2) not deducting deposits to the checking account from the "unpaid principal amount" of the Checking Plus loan accounts.

By opinion dated November 7, 1973, the district court (Duffy, J.), in relevant part, held that: (1) the $100 multiple device is illegal as it could not be "reconciled with the statutory requirement that loans be made 'by means of honoring' " checks. The District Court found that:

> "Advancing funds in multiples of a hundred dollars does not constitute honoring a check." (A66-67);

(2) The failure to deduct deposits to the checking account from outstanding Checking Plus loans did not violate Sections 108(5)(d) & (f) of the New York Banking Law. The District Court found that:

> "The requirement that payments be made to one account rather than the other does not 'entail additional expense or sacrifice' of the kind referred to in the statute." (A69)

Based on the foregoing decision, the Court entered an order dated January 28, 1974 which in relevant part, provided as follows: (a) granted summary judgment to the plaintiff on that portion of its claim asserting the illegality of the $100 multiple device (para.(5)(a) (A71-72); (b) enjoined defendant from further using the $100 multiple device with respect to the plaintiff only (para.(5)(b) (A72); (c) granted summary judgment to plaintiff "in such amount as shall be found to be due to him as damages, plus such penalties as may be found due. . ." (para.(5)(c) (A72); and (d) granted defendant's motion and denied plaintiff's cross-motion requesting summary judgment, with respect to defendant's practice of failing to deduct deposits to the checking account as repayments of outstanding Checking Plus loans (para.(4) (A71).*

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* Class action determination had been deferred by stipulation of the parties pending the determination of the merits. The District Court restored plaintiff's class action motion to its calendar after the said order was signed. Defendant unsuccessfully sought a stay of (con't)

The defendant has appealed from decretal paragraph (5) of the said January 28, 1974 order. Plaintiff has cross-appealed from decretal paragraph (4) thereof.

C. Facts

Plaintiff has a checking account with defendant. Simultaneously with opening this checking account and as an agreement collateral thereto, plaintiff also entered into a Checking Plus credit agreement (A35). Under the terms of this agreement the plaintiff "was entitled, inter alia, to draw checks against his special checking account in excess of the credit balances thereof. . ." in multiples of $100 only as a condition precedent to the entering into of the agreement and the granting of such loans (A25). Plaintiff initially was entitled to overdraw his account up to a maximum of $1,200 (A34). This amount was subsequently increased to $2,000 (A48).

Monthly statements relating to the said checking account and the Checking Plus loan account reveal that various loans were made to plaintiff in connection with his overdrafting his checking account (A36-41). Similarly, the statements reveal that various deposits were made in plaintiff's checking account.

All overdraft loans were made to plaintiff in multiples of $100

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class action determination from two judges in the Court below, (Duffy and Lasker, JJ.). Defendant then obtained a stay from this Court by order dated March 12, 1974.

only, notwithstanding that the actual amount of the overdrafts were in lesser sums. All deposits to the checking account were not deducted from outstanding Checking Plus loans. It is undisputed that defendant uniformly uses both these procedures in connection with plaintiff's account and all its checking account customers who have Checking Plus accounts. Defendant's response to plaintiff's interrogatory number 6, on this point, is as follows:

> "Interest charges on Checking Plus credit agreements are computed in a uniform manner. . .".

Summary of Argument

The two issues before this Court are unclouded by factual disputation. Defendant concedes that it uses the $100 multiple device and fails to deduct deposits to the checking account from outstanding Checking Plus loans.

Consequently, this Court as a matter of law, based on principles of statutory construction applicable to the circumstances herein, can determine whether each of these devices is permissible under N.Y. Banking Law, Section 108(5) and the National Bank Act (12 U.S.C. Secs. 85 and 86), or the Uniform Commercial Code.

Plaintiff asserts that each of these devices is illegal, unconscionable and patently inequitable. Further, that these devices are no more than predatory schemes to exact excessive interest charges from plaintiff and the class he represents and to derive additional

revenue from increased lending activities made possible by forced deposit balances required. These benefits to defendant are at the sole expense and sacrifice of bank customers and wholly without any advantage to them. The adverse economic consequences of these devices to bank customers is obvious. Defendant knowingly followed these practices despite these adverse consequences.

a. $100 Multiple Device

The New York Banking Law, Sec. 108(5) was enacted in 1960. It authorized agreements "pursuant to which loans could be made by 'honoring' checks (108(5)(a). The $100 multiple practice violates this statute because to "honor" a check means to pay it according to its tenor. To the extent the checking account does not have sufficient funds to cover such check, an overdraft loan is permitted under the statute. Defendant, however, arbitrarily and in violation of the plain words of the statute compels loans in multiples of $100 only, regardless of the actual amount of the overdraft. The Court below properly held this device to be illegal.

The $100 multiple scheme not only violates the plain words of 108(5)(a), but the plain words and clear intent of other subdivisions of this remedial statute which seek to place a maximum ceiling on interest charges which cannot be circumvented or evaded. The intent

of the statute to limit all charges and expenses to the maximum 1% per month is made evident by 108(5)(e) & (f). This latter provision, for example, expressly prohibits any bank from requiring "a borrower to keep any sum on deposit,. . . or to do or refrain from doing any act which would entail additional expense or sacrifice as a condition precedent to the entering into of the agreement or granting of a loan. . .".

It is undisputed that the $100 multiple practice causes greater interest charges to be exacted from bank customers. Indeed, defendant makes elaborate computations, not before the Court below, or relevant to its decision, or to this Court's decision, to show what it claims such additional amounts are in the case of plaintiff. (Def's Br., pp6-12).

Even without the benefit of the carefully wrought language of 108(5), usury statutes are traditionally construed so as to benefit consumers by preventing schemes disguised with the cloak of spurious legality.

Further, it is submitted that the $100 multiple scheme violates the "good faith" requirements of the Uniform Commercial Code (Sec.1-203; Sec.4-103) as well as the unconcionable standards of Sec. 2-302 thereof.

b. Failing to Deduct Payments

The failure of defendant to deduct deposits to the checking account

of plaintiff and other class members from outstanding Checking Plus loans, it is submitted, violates the plain words of 108(5)(b)(i) which mandates that interest be computed,under the average daily balance method used by defendant, "on the unpaid principal amount. . .". A deposit to the checking account is a payment reducing the "unpaid principal amount... . outstanding".

Plaintiff's interpretation of 108(5)(b)(i) is buttressed by 108(5)(d) and 108(5)(f). Subdivision (d) encourages early payments so that interest charges are minimized. Subdivision (f) prohibits any practice or act, or non-act, or "additional expense or sacrifice" as a condition precedent to granting a loan or entering into a loan agreement. Defendant's failure to deduct deposits likewise violates these two subdivisions.

As a matter of law, both of the foregoing schemes violate 108(5) and the applicable provisions of the Uniform Commercial Code.

POINT I

THE $100 MULTIPLE DEVICE IS AN ILLEGAL, UNCONCIONABLE AND PREDATORY SCHEME

A. Introduction

In 1960, New York Banking Law, Sec. 108(5) was enacted. (L. 1960, c.784, sec.1). This section permitted banks to "establish credits

under written agreements with borrowers, pursuant to which one or more loans or advances to or for the account of the borrower may be made from time to time, by means of honoring one or more checks or other written orders or requests of the borrower. . ." (emphasis supplied).

In 1966, six years after its enactment, Citibank established its Checking Plus account (Def.'s Br., p.36).* This plan was only available to those with Citibank checking accounts. (A55-58). The advertising of Citibank emphasizes the convenience of writing check overdrafts. For example: "It's like writing yourself a loan. . . No worry. We automatically loan you the money to cover it." (A58) (emphasis supplied). This typical advertisement goes on to state:

> "You can use Checking Plus as much or as little as you want. It doesn't cost you a cent until you use it." (A58)

Prior to the enactment of the 1960 statute and in or about 1959,

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* In a companion case, Landau v. Chase Manhattan Bank, 367 F.S. 992 (S.D.N.Y. 1973) a similar check overdrafting plan was started by Chase Manhattan Bank in 1967, except that under the Chase plan interest was imposed on the actual amount of the overdrafts and not on multiples of $100. Manufacturers Hanover Trust Co. and Bankers Trust Co. have also established plans of this type. However, they do not utilize the illegal practice (A49) of the $100 multiple. Citibank does not challenge these facts.

Citibank established what it called a "Ready-Credit" account.* Pursuant to the terms of that type of account, advances would be made to those who did not have checking accounts with Citibank. These advances were made based upon "written orders or requests of the borrower." As the Checking Plus accounts, these advances would be made up to an agreed upon maximum amount. Unlike the Checking Plus account, such advances were made not in multiples of $100, but for the exact amount requested.

The Checking Plus accounts and Ready-Credit accounts are separate and distinct accounts offered by Citibank. As indicated above, the manner of request for a loan under the Checking Plus account is the drafting of a check in an amount larger than the balance in a checking account. The manner of request for an advance under the Ready-Credit account was pursuant to "written orders or requests of the borrower." Under such circumstances, it is entirely inaccurate for Citibank to assert that plaintiff had an option to use a "written order or request" to obtain a loan. The convenience of a check-credit plan, vigorously promoted in defendant's advertising, would be severely diminished if Checking Plus customers were to exercise the so-called

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* Supplemental Answer to plaintiff's Interrogatory No.6 in the companion case of Rosenspan v. First National City Bank, Civ. No.72-4515 (S.D.N.Y.), where Citibank's motion for summary judgment was denied with respect to a claim that Citibank was illegally compounding finance charges, i.e., charging interest on interest.

option. Even if, arguendo, plaintiff had such an option, the mere existence of the option would not legalize Citibank's illegal $100 multiple practice. Moreover, plaintiff does not have a Ready-Credit account and hence cannot exercise such option.

B. Evils of Method

It is axiomatic that the real nature and character of a transaction will be scrutinized to determine if the usury laws are violated. A court will inquire into the real nature of the transaction and will look beyond every device or trick used in an effort to defeat the usury statutes (Williston on Contract, Sec. 1687, p.726, 3d Ed.). In examining the true nature of the practices herein, the "shape or disguise the transaction may assume" cannot shield the lender if an intent to obtain more than legal interests for the use of money can be discovered. . ." (32 N.Y. Jur. Interest and Usury Sec.37).

An examination of the consequences of the use of the $100 multiple practice shows it to blatantly violate the statutory limitations and to be an unconscionable scheme to evade the spirit and letter of the usury laws.

To illustrate: If a lender were to offer to lend $100 at 6% simple interest, on the condition that the borrower deposit $50 with the lender for the period of the loan, it would be apparent that the lender really was lending $50 at 12%.

Citibank's $100 multiple practice is merely a variation of the foregoing example. A forced deposit is created in one's checking

account equal to the difference between $100 and the actual amount of the overdraft loan. A forced loan of equal amount upon which interest is exacted is simultaneously created.

In making commercial loans, which are not subject to the usury laws, as opposed to the personal loans involved herein, such a practice is known as a "compensating balance" requirement. It is clear that "compensating balances" or "forced deposits" increase the effective interest rate and "is nothing more than an indirect means of increasing the interest rate on the effective usable amount of the loan." (58 Virginia L. Rev. 1, 10-11).

These "compensating balances" or "forced deposits" may have various market place justifications which may be relevant in connection with antitrust considerations which are not per se violations. However, they would not apply to a violation of the usury laws.

The intent of the legislature to restrict the amount of interest that may be charged cannot be violated because of an alleged reasonableness of the practice. It is for the legislature to determine reasonableness, not this Court. American Airlines, Inc. v. Remis Industries (2d Cir. 1974 C.C.H. Cons. Credit Guide, para.98, 849. Certainly, it is not banks which decide this reasonableness, although defendant asserts that the "realities of the marketplace, rather than the compulsion of law, govern banks' determinations. . ." (Br. p.36).

Nor may a contract provision render nugatory the statutory requirements. It has been held in a leading case construing the National Bank Act and local state law (Daniel v. First National Bank of Birmingham, 227 F.2d 353 (5th Cir. 1955), rehearing den., 228 F.2d 803, as follows:

> "Usurious contracts are condemned by public policy both state and national [citations]. That public policy cannot be defeated by the simple expedient of a written contract, but the real substance of the transaction must be searched out". (p.355)

Each and every time a check overdraft is made, excessive interest charges are exacted from bank customers with Checking Plus accounts. For example, in August 1972 the plaintiff drew four checks totalling $701.36 in actual overdrafts. This resulted in total loans of $900 because of the $100 multiple device, or nearly $200 more than required to "honor" the overdrafts (A50). The average amount of the forced balance in the checking account and forced loans upon which interest accrued for each of these overdrafted checks was $50.00 per check. As a result, the effective interest rate by use of the $100 multiple practice was substantially increased, the actual amount of interest chargeable to bank customers was substantially increased and the lending base upon which additional profits could be made was increased nearly six-fold. (pp. 39-40, infra)

C. Illegality

1. Statutory Violation

The National Bank Act (12 U.S.C. Sec.85) prohibits a National bank from charging interest that "exceeds the rate allowed by the laws of the state. . . where the bank is located." It is undisputed that Citibank is a national bank subject to the National Bank Act. The applicable state law is New York Bank Law, Sec.108(5).

The district court's determination that the $100 multiple practice was illegal was based on the clear and unambiguous language of 108(5)(a) and the public policy underlying the usury laws. It could not reconcile the $100 multiple device with the statutory requirement that loans be made by means of honoring checks. In a nutshell, it held:

> "Advancing funds in multiples of a hundred dollars does not constitute honoring a check." (A66-67)

A traditional definition in commercial usage of the statutory term "honor" is ". . . to pay a note, check or accepted bill, at maturity and according to its terms. . .". Black's Law Dictionary (Rev. 4th Ed. 1968). This definition of "honor" has been codified in New York where it is defined in the New York U.C.C. Sec. 1-201 (21) as follows:

> "To 'honor' is to pay or to accept and pay. . .".

Defendant argues that the arbitrary $100 multiple is actually known to plaintiff pursuant to a specific term of the Checking Plus

agreement. The defendant ignores, however, (1) the statutory requirement that the loan be commensurate with the amount of the overdraft; (2) the statutory requirement which requires the "written agreements with borrowers" to comply with the statute; (3) that Checking Plus customers are forced to incur loans not necessary to "honor" their overdrafts and have interest charges exacted from them on this forced loan; (4) that a customer is forced to maintain a deposit balance in his checking account equal to the forced loan, which permits additional revenues to be derived by defendant at the customer's added expense and sacrifice.

The public policy underlying the usury laws "cannot be defeated by the simple expedient of a written contract." Daniel v. First National Bank of Birmingham, supra; Accord: U.S. v. Loews, Inc., 371 U.S. 38, 51 (1962).

Although the District Court did not specifically refer in its decision to 108(5)(e) or (f), its reference to the "strict public policy underlying the usury laws" (A67) was undoubtedly predicated on these sections. They unassailably demonstrate that the legislative intent of 108(5) that the maximum rate of interest of 1% per month is inclusive of all additional charges, except for certain enumerated charges not relevant herein, and to prevent the use of any devices to evade the maximum rate limitations.

The $100 multiple device violates the express prohibitions of 108(5)(f) as it forces plaintiff to borrow excessive funds, forces him to pay excessive interest charges and forces him to maintain excessive checking account balances.

Notwithstanding the foregoing, defendant claims that it may set the "minimum" amount of a loan and that the $100 multiple device establishes this minimum. Defendant ignores, however, the maximum limit as to check-credit loans mandated by 108(5)(a), to wit, no more than necessary to "honor" a check drawn upon an overdrafted checking account.

2. Illegality of Schemes to Evade Usury Laws

Even witnout the clear, unambiguous language of Sec.108(5), the $100 multiple practice would run "afoul of the usury statutes." (Williston on Contracts, Sec.1687, p.728). The lender may not "secure any profit or advantage in excess of the return permitted by law." (91 C.J.S. Usury, Sec.28, p.603).

Various schemes to disguise the usurious transactions in a cloak of legality have been consistently rejected by the state and federal courts of New York and other jurisdictions.

(a) Forced Deposits:

East River Bank v. Hoyt
32 N.Y. 119 (1865)

Butterworth v. Perone
8 Bos. 671 (N.Y. 1861)

Planters National Bank of Virginia v. Wysong & Miler Co.
99 S.E. 199 (N.C.Sup. 1919), cert. den.,
250 U.S. 655, 12 A.L.R. 1412

(b) Declining Balances Not Recognized:

Vee Bee Service Co. v. Household Finance Corp.
51 N.Y. S. 2d 590, 606-607 (Sup.N.Y. 1944)
aff'd 269 A.D. 772 (1st Dept. 1945)
See: 37 Fordham L. Rev. 209, 214

Cohen v. District of Columbia National Bank
(D.C.D.C. [illegible]. 1974), 42 L.W. 2543

(c) Interest in Advance:

Koven v. Kline,
254 A.D. 307 (1st Dept. 1935)

Tuition Plan Inc. v. Zicari
70 Misc. 2d [illegible] (D.C. Suffolk 1972)

(d) Use of 360-Day Year:

American Timber and Trading Co. v. First National Bank of Oregon
___ F.2d ____, (9th Cir. 1973), C.C.H. Cons. Credit Guide, para. 98, 929

Silverstone v. Shadow Lawn Savings & Loan Association
237 A. 2d 474 (1968)

Pearlman v. First National Bank of Chicago
C.C.H. Fed. Banking L. Rep., para. 96, 148
(Ill. App. 1974)

(e) Miscellaneous:

State of Wisconsin v. W. T. Grant Co.
C.C.H. Cons. Credit Guide, para. 99, 146
(Cir. Wisc. 1972); Ives v. W.T. Grant Co.,
C.C.H. Cons. Credit Guide, para. 98, 847
(D.C. Conn. 1974)
(Interest charges imposed not on the actual purchases made with coupons but on the face amount of the coupon books.)

Stubach v. Sussman, 281 N.Y. 719 (1939)
(subterfuge of additional charge because of potential hazards to property)

Metcalf v. Bartrand
C.C.H. Cons. Credit Guide, para. 99, 262
(Alaska Sup. 1971)
(scheme by a mortgagee in a mortgage transaction in which a sales and repurchase agreement was used as a mortgage device)

Flannery v. Bishop
C.C.H. Cons. Credit Guide, para. 99, 093
(Wash. Sup. 1972)
(charging interest in the full amount of the loan, but only giving borrower 90% thereof)

In short, as stated in the landmark usury case of Madison Personal Loan v. Parker, 124 F.2d 143 (2d Cir. 1941):

"Loopholes in statutes are best closed by complete closing. Halfway measures are dangerous." (p.146)

3. Statutory Interpretation

A. Plain Words of Statute

The plain words of 108(5)(a) permit banks to establish check-credit agreements "pursuant to which" loans may be made "by means of honoring" checks. There is absolutely no sanction in this section for the use of the $100 multiple scheme. The plain intent of the statute to prevent the use of any scheme or device, such as the $100 multiple scheme, to create additional charges or interest expense is made explicit by the catch-all provisions of 108(5)(e) and 108(5)(f).

Even without the carefully wrought restrictions of 108(5)(e) and 108(5)(f), 108(5)(a) would mandate that no additional charges or expenses be foisted upon customers by not just "honoring" check overdrafts. This mandate would be based on (i) the strict public policy

underlying the usury laws found by the district court below (A67); (ii) the maxim "expressio unius est exclusio alterius", i.e., ". . . where a law expressly describes a particular act, thing or person to which it shall apply, an irrefutable inference must be drawn that what is omitted or not included was intended to be omitted or excluded". (McKinneys Consol. Laws, Statutes, Sec.240); (iii) remedial legislation should be construed liberally so as to effectuate its purpose. Madison Personal Loan v. Parker, supra; Accord: Tcherpain v. Knight, 389 U.S. 332, 336 (1967); Monarch Life Ins. Co. v. Loyal Protective Life Ins. Co., 326 F. 2d 841, 845 (1963); McKinneys Cons. Law Statutes, Sec.321 and 341.

The defendant argues that these plain words are overcome because plaintiff had no "vested" right to overdraft his account. This argument is predicated upon a clause in the agreement which allowed Citibank, or the borrower, to terminate the agreement at any time, except with respect to outstanding checks and obligations. (A35). Such termination would appear to be exercisable by defendant only if done in good faith, not arbitrarily. U.C.C. Secs.1-208, 1-203, and 4-103. See: Shell Oil Co. v. Marinelli (N.J. Sup. 1973), C.C.H. 1973-2 Trade Cases para. 74,604.

In any event, however, the theoretical right of cancellation, if any, is irrelevant to this action where such cancellation was not

made. The mere presence in a contract of a bilateral termination clause "has no effect on the binding obligations of a contract as long as the parties continue to act under it before evoking or terminating it."* Each and every time that plaintiff or other Checking Plus customers drew a check that required a Checking Plus loan to "honor" the overdraft, an improper additional interest expense was exacted and a forced deposit created.

Defendant's present argument on this point is the reverse of that it took in the district court. There, it claimed as an undisputed fact that plaintiff "was entitled" to overdraw his account (A25). The question at bar, however, as to whether the statute has been complied with, is not affected one whit. Defendant's rhetoric appears to be an attempt to obscure this central issue of statutory construction.

B. Legislative History

Defendant concedes that the legislative history of 108(5) is "not conclusive on the issues now before this Court" (Br.27). Under the circumstances herein, to wit, an unambiguous statute, and a concededly inconclusive background, "resort to legislative history is unjustified". American Airlines Inc. v. Remis Industries, supra, p.13; Holtzman v. Schlesinger, 484 F.2d 1307, 1314 (2d Cir. 1973).

Notwithstanding such concession, Citibank then goes on to state its version of the legislative history, as follows:

* Art Infant's Wear v. Turk, 272 A.D. 138, 139 (1st Dept. 1947) aff'd. 297 N.Y. 752 (1948)

(i) Amicus New York State Bankers Association, who had been involved in the drafting of the 1960 legislation, interprets the section as allowing, inter alia, the making of loans in multiples of $100. (br. p.28); (ii) the Banking Department "has never questioned the validity of the widespread practice" (Br. p.29); (iii) the legislature has amended the statute 8 times since 1960 and such legislative enaction is an indication of the legality of the method. (Br. p.29); (iv) Zachary v. Macy & Co., 31 N.Y. 2d 443 (1972), r'v'g. in part, 39 A.D. 2d 116 (1st Dept. 1972), is supportive of its position.

The foregoing factors do not militate against the decision of the court below, for the following reasons:

1. The interpretation of the statute by Citibank's trade association is entirely irrelevant. A similar argument was rejected by the New York Court of Appeals in State of New York v. Garlick Chapels, Inc., 30 A.D. 2d 143, (1st Dept. 1968), aff'd., 23 N.Y. 2d 754 (1968). In Garlick, the trade association of the funeral industry unsuccessfully asserted in its brief as follows:

> "The statute as passed undoubtedly reflects agreement between the Association and the Attorney General's Albany office. Yet the Attorney General now tries to attach to the law a meaning never communicted to, or agreed to, by either the Association or the Legislature". (p.9)

2. The New York Banking Department has no jurisdiction over national banks. The Comptroller of the Currency has such authority. A recent report "Consumer Credit in the United States" (Dec. 1972) by the National Commission on Consumer Finance, established by Public Law

90-321, chastises the Comptroller's Office for its dereliction in protecting consumers in the following language:

> "The Comptrollers' failure to examine for and enforce such consumer protection laws [state laws] is particularly serious because the Comptroller's Office is the sole regulatory and supervisory authority for national banks." (p.54) (Emphasis supplied)

This report similarly criticizes State banking departments for their over emphasis on financial soundness of bank activities, leaving "other bank supervision functions, such as detection of fraud and irregular consumer credit practices, a poor second in the scale of priorities. . ." (p.53). The Commissioner concluded as follows:

> "Consumers are entitled to much better consumer credit protection law enforcement at the state level than they have been receiving" (p.61)

Indeed, even if the regulatory agencies had finally ruled that the scheme was legal, which they have not, a long line of cases hold a view which is succinctly stated in Louisville R.R. v. U.S., 282 U.S. 740 (1930) as follows:

> "Long continued practice and the approval of administrative authority may be persuasive of the statute, but cannot alter provisions that are clear and explicit when relating to the facts disclosed. A failure to enforce the law does not change it." (p.759) (Emphasis supplied)

Accord: Standard Oil Co. v. Fitzgerald, 86 F.2d 799, 802 (6th Cir.1936), cert. den., 300 U.S. 683; Philips Petroleum Co. v. The State of

Wisconsin, 247 U.S. 672, 677 (1954); Nantahola Power and Light v. FPC, 384 F.2d 200, (4th Cir. 1967); N.Y.S. Public Service Commission v. Grand Central Cadillac, 273 A.D. 595, 598, (1st Dept. 1948); Rosenbluth v. Finkelstein, 300 N. Y. 402, 405 (1950); SEC v. Cogan, 201 F.2d 78, 83 (9th Cir. 1951); Speirit v. Bechtel, 232 F.2d 241, 244, (10th Cir. 1956); Jewel Ridge Corp. v. Local Union, 324 U.S. 161, 166 (1944).

The New York Banking Department has remained silent on this issue, or as phrased by Citibank, has "never questioned" the practice. The finding of the National Commission on Consumer Finance as to the failure of state agencies to protect consumers would appear to be applicable here.

Lastly, the New York Banking Department, even if it had jurisdiction, would only have the statutory authority to hold hearings and make findings based on individual complaints (N.Y. Banking Law, Sec.498). The individual consumers, however, could not obtain monetary redress through the Banking Department.

3. Contrary to the essential finding in Zachary, supra, that the challenged practice there "had been widely employed in New York since the early 1950's" and was "the method most commonly used by retailers. . . at the time of the enactment of the Retail Installment Sales Act," the $100 multiple scheme has no such history. Even Citibank

does not claim that the practice existed prior to the enactment of 108(5) in 1960. Citibank states:

> "Since enactment of the Section in 1960, revolving credit on check-credit plans have gained wide acceptance throughout the state. . ." (Br.p.28) (Emphasis supplied)

Obviously, neither Citibank, nor its amicus, is able to show a previous history of common use of the $100 multiple scheme prior to the 1960 statute. Not one bank that used the scheme prior to the enactment of the statute is set forth. As the largest bank in the state and a leader in the industry, Citibank first employed the scheme in 1966. Similarly, Chase Manhattan Bank, New York's second largest bank, started its check-credit account in 1967, albeit without the $100 multiple scheme.

4. The fact that the legislature has amended 108(5) eight times since 1960 is indicative, not of the legislative approval of the method, but rather that the legislature did not consider such legislation necessary. In any event, the U.S. Supreme Court in N.L.R.B. v. Plasterers Local Union 404, U.S. 116, 129-130 (1971) has stated:

> ". . . that it is at best treacherous to find in Congressional silence alone the adoption of a controlling rule of law. . . In the absence of an 'unmistakable directive', the Court has refused to construe legislation aimed to protect a certain class in a fashion that will run counter to the goals Congress clearly intended to effectuate."

(Accord: U.S. v. Price, 361 U.S. 304, 313 (1960).

C. Analogous New Jersey Statute

The New Jersey statute referred to by defendant (Br., p.19) is stated to be "strong support for interpreting Section 108(5)(a) of the New York Banking Law as permitting the same type of 'advances' in multiples of $100.00". Defendant opines that the word "advances" in the New York statute is synonymous with the word "advances" in the New Jersey statute. It, therefore, concludes that the $100 multiple practice which is now legal in New Jersey is, therefore, permissible in New York.

For at least the following four reasons, the New Jersey statute lends no support to Citibank's position. To the contrary, the New Jersey statute clearly shows the correctness of the decision of the Court below.

1. The agreement between the parties herein does not refer to "advances", but to 'Loans hereunder", whether as a check overdraft in multiples of $100 or, upon acceptable written authorization." (A35, first para. thereof).

2. No definition is given by Citibank to distinguish "loans" from "advances". In fact, Citibank defines "loan" as "an advance of money with a promise to repay." (Br., p.13) (Emphasis supplied). Similarly, the New Jersey statute states that "a bank may lend money

to a borrower by advancing funds to or for the account of the borrower pursuant to the borrower's written authorization." (N.J. S.A. Article 12(a), Sec. 17.9A-59.1 (1973-74 Cum. Supp.) (Emphasis supplied). This New Jersey terminology is employed for both check overdraft and written authorization type loans.

"Advances" is a word which "depends for its meaning, upon the context or surrounding circumstances." 2 C.J.S. Advances, p.629. In general, the word has the same significance as the word "loan". (Encyclopedia of Banking and Finance (1962 ed.). Its more particularized meaning would be a loan of money. (Black's Law Dictionary (4th ed.); Prentice-Hall Encyclopedia Dictionary, Dept. of Business Terms (1966 ed.). The New York statute would appear to use the word "loan" in 108(5)(a) to refer to the giving of a loan by honoring overdraft checks, whereas the word "advances" would refer to money loans pursuant to "other written orders or requests". In any event, however, "advances" could not be construed in the New York statute as permitting the $100 multiple practice, nor in the New Jersey statute.

3. The New Jersey statute contains no provision comparable to 108(5)(e) and 108(5)(f) precluding devices and schemes to evade the usury laws. Nor does the New Jersey statute limit credit agreements "pursuant to which" loans or advances could be made by means of honoring one or more checks. . ." (108(5)(a).

4. Most crucially, the New Jersey statute expressly authorizes the $100 multiple practice. The New Jersey legislature recognized that such practice could only be legal if expressly permitted by the legislature. Obviously, the use of the word "advances" by itself did not authorize a $100 multiple scheme. The New York legislature, on the other hand, has taken an approach wholly deviating from the New Jersey statute. Not only does the New York legislature not expressly authorize the $100 multiple scheme, it prohibited it by the plain words of 108(5)(a) and 108(5)(f). The issue before this Court is not whether the New York legislature has the power to so legislate, but whether it has done so. The answer is clearly in the negative.

D. Flagrant, Knowing Violation

Since 1966, in utter disregard of the plain words of 108(5), when the defendant instituted its Checking Plus loan account, it has employed the illegal $100 multiple scheme. It is undisputed that a higher effective rate of interest than permitted by 108(5) results from the $100 multiple practice. It is undisputed that loans and deposits greater than the amount which would have been credited by "honoring" checks in accordance with the statute have been forced upon plaintiff and other bank customers, resulting in higher interest costs to them. Additionally, defendant has derived additional revenue from the forced deposits because of its lending base being increased.

Under the National Bank Act, (12 U.S.C. Sec 86), a two-year statute of limitations is applicable. Thus, defendant may well have violated that statute with impunity for the years 1966, 1967, 1968, 1969 and until October 1970, two years prior to the commencement of this action. Defendant's attempt to immunize themselves from even this two-year period is hardly fair or equitable to the consumer class which has been bilked.

Citibank has had notice of the claimed illegality since October 1972, when this action was commenced. It persisted in using the challenged practice despite this action. Even in November, 1973, when the District Court held the scheme illegal, defendant continued to use this scheme. Finally, even after the injunction issued by the District Court in January, 1974, defendant persisted in using the illegal scheme.

Despite the foregoing background, Citibank now, after having violated the statute with impunity for nearly five years, and because of the failure of governmental agencies to protect consumers during this entire period, asks this Court for equitable relief, to wit, to give only prospective effect to the illegality of the method.

Basic principles of equitable jurisdiction require that he who seeks equity must do equity and with "clean hands". Citibank has done neither. It has not offered to do equity by refunding the actual

past overcharges which are plainly due to the plaintiff and the other members of the class, even without a knowing violation of the statute, under the theory of unjust enrichment and money had and received; nor, has it used the method pursuant to a good faith interpretation of the plain words of the statute. The statute is quite clear on its face and cannot be interpreted to allow any scheme to evade the limitations of 108(5).

Defendant's application for equitable relief, should be denied for the above considerations alone. However, there are additional factors present herein, warranting such denial. They are as follows:

a). The relief requested is not ripe for determination. The only issue before this Court is the legality of the scheme pursuant to 108(5). The question of damages pursuant to Section 86 of the National Bank Act is not before this Court. This would be a question remaining for determination by the trial court, and subject to appeal thereafter, even if this Court affirmed the Court below.

b). As authority for this novel application, Citibank cites the South Dakota case of Rollinger v. J.C. Penney Co., 192 N.W. 2d 699 (1971). The Rollinger case, is distinguishable from the within situation in many respects. It did not involve the construction of the plain words of a statute. Indeed, South Dakota had no statute

dealing with revolving credit. The Court, however, overturned the decisional law authorizing the time-price exemption to the usury laws which was prevalent in South Dakota. J.C. Penney had relied upon the long-standing decisional law of that state. Here, the plain words of the statute prohibit the practice. Defendant does not rely on long-established decisional law permitting such a scheme. In the New York state courts, C.P.L.R. 7205 is controlling on this point. This section provides as follows:

> "No action for a penalty or forfeiture may be brought for an act done in good faith and pursuant to a construction given to a statute by a decision of an appellate court and adjudged lawful thereby, where such act was done prior to a reversal or the overruling of such decision".

Thus, defendant would have to show that it had acted in good faith and pursuant to a decision of an Appellate Court. Neither of these criteria can be met by defendant.

c). The $100 multiple scheme is more than illegal. It is a practice which is unconscionable and inherently inequitable, as more particularly set forth in Point I, subd.4, infra. One following an unconscionable and inequitable scheme is not in a position amenable to the equitable shield of this Court.

d). Defendants further contend that they have not knowingly violated the statute. Defendant is incorrect. Under the usury laws "knowingly" means no more than that "a person deliberately adopts a

mode of computing interest which will give more than the legal rate of interest, he will be held to have intended the legal consequences of his act." N.Y. Jur. Interest and Usury, Secs.73-72). Where illegal interest is exacted as a consequence of using a practice, the law implies a usurious intent. DeKorwin v. First National Bank, 170 F.S. 112, 128 (N.D. Ill. 1958), aff'd., 275 F.2d 755 (5th Cir. 1960); National Equipment Rental v. Stanley, 177 F.S. 583, 586 (E.D.N.Y. 1959), aff'd., 283 F.2d 600 (2d Cir. 1960). A mistake of law is likewise no justification for use of an illegal practice. 14 Williston on Contracts, Sec. 1698A, (3d Ed.); 91 C.J.S. Usury, Sec.14(c). If it were, all wrongdoers who consult lawyers would be able to violate the law.

Indeed, even in the early case of the Bank of the United States v. Waggener, 34 U.S. 395 (1835) cited by Citibank, (Br. p.30) which predates the enactment of the National Bank Act in 1863, where the "contract upon its very face imports usury. . . the intent is apparent, res ipsa loquitur"(p.400). The $100 multiple scheme on its face imports usury.

Even "willful" under criminal statutes "means no more than the person charged with the duty knew what he was doing. It does not mean that, in addition, he must suppose he is breaking the law." American Surety Co. v. Sullivan, 7 F.2d 602, 605 (2d Cir. 1925).

This definition has now been codified in New York Penal Law (Sec. 15.05, subd. 2). See also: People v. Broady, 5 N.Y. 2d 500.

In U.S. v. Futura, 339 F.S. 162, 168 (N.D. Fla. 1972), it was sufficient to constitute willfulness that a defendant "was aware of" the law and "intentionally" violated it "because they felt that the act did not apply to them". A similar result has been reached where one "either intentionally disregards the statute or is plainly indifferent to its requirements". Steere Tank Lines v. U.S., 330 F.2d 719, 722 (5th Cir. 1963); Accord: Riss & Co. v. U.S., 262 F.2d 245, 248 (8th Cir. 1958).

The foregoing criteria applied in the circumstances of this action show defendant knowingly violated the statute. A prospective application of the illegality of the $100 multiple scheme would be grossly unfair and inequitable and perhaps, unconstitutional, to the consumers illegally overcharged.

4. Unconscionability of Practice

A. U.C.C. Applies

The New York Uniform Commercial Code is applicable to bank transactions. Articles 3 and 4 spell out particular provisions relating thereto and Article 1 contains general definitions and standards of construction applicable to both of these articles. (Sec.3-102 (4); 4-104). "Unless the context otherwise requires", Article 2-302

and other provisions of Article 2 relate to all transactions covered by the Code (Sec.2-102). Sec 2-302 has been held to apply, for example, to the sale of securities (Bache & Co. v. International Controls Co., 339 F.S. 341 (S.D.N.Y. 1972) , and equipment leases (Electronic Corporation of America v. Lear Jet Corp., 55 Misc. 2d 1066 (Sup.N.Y. 1967).

Sec.1-203 imposes "an obligation of good faith" on contracting parties. This "obligation of good faith" in the case of a bank cannot be waived by contractual provision. Section 4-103 expressly provides as follows:

> "The effect of the provision of this Article may be varied by Agreement except that no agreement can disclaim a bank's responsibility for its own lack of good faith." (Emphasis supplied)

The Checking Plus contract offered by defendant to plaintiff was a contract of adhesion. Neither the plaintiff nor other checking account customers is offered a choice of contract. All are identical form contracts, not the subject of negotiation. As stated by defendant, in response to plaintiff's Interrogatory number 6:

> "Interest charges on Checking Plus credit agreements are computed in a uniform manner. . .".

In order to open a Checking Plus account, it is mandatory that an agreement be signed which allows the bank to "use the $100 multiple practice."(A35)

B. Defendant's Contentions

Defendant defends its practices as reasonable because banks are "legally free" to make business judgments on loans based on the "realities of the market place, rather than the compulsion of law". (Br. 35-36). Such position is tantamount to asserting that banks are not subject to the usury laws. This proposition can only be characterized as frivolous.

The question of reasonableness is not relevant to whether the usury statute is violated. However, as to whether the $100 multiple device is unconscionable, certainly the question of reasonableness is applicable.

As a second contention, Citibank claims that $100 as a minimum loan is reasonably related to the average check drawn by Citibank customers. It cites not one scintilla of evidence on this point, however, except a wholly misleading calculation as to plaintiff's account. (Br. 36-37). It claims that the plaintiff had an average face amount of checks drawn by him of $83.60. The actual calculations are shown on page 12 of defendant's brief. Defendant wrongfully assumes that it is the average check drawn that is pertinent. The true measure of this contention would be shown by the average difference between the total overdraft loan caused by the $100 multiple practice and the actual amount of the check overdraft.

It is only those checks which represent overdrafts which are relevant. Under this standard, in August 1972, for example, the average differential of plaintiff's checking account amounted to nearly $50 per check for the four checks drawn. Consequently, Citibank under its practice had forced loans and increased interest charges to plaintiff in an amount equal to 100% more than the actual overdrafted amounts. This is hardly a paradigm of fairness.

As a third contention, Citibank claims that the $100 multiple practice is not unconscionable because it could have used other more expensive methods and added other additional charges. Firstly, it claims that since loans under the contract "shall be deemed to have been made at the time of presentment of such checks" (Br., p.12), defendant could have charged interest at this earlier date. Citibank overlooks, however, that having loans "deemed" to run from the date of presentment is in itself violative of 108(5). It would mean interest would commence before a check is "honored", i.e., paid. The position of defendant in this regard is different than that maintained in the Court below. Plaintiff's interrogatory number 4(f)(iv) requested information as to whether overdrafts are debited on the date the check is presented for payment, or otherwise explaining such other system, if any. . .". Citibank's response was:

"(iv) Yes, within normal time limits".

Thus, the normal procedure followed by Citibank appears to be a violation of 108(5). In any event, defendant's presentation of this contention in its brief (p.11) is considerably less enlightening than footnote "1" of the statement of its accountant to the court below (A47). Its accountant's statement shows that the one to three-day delay represented a difference between the time when plaintiff showed an overdraft position in its checking account, i.e., presentment for payment, and the recording of such position in the Checking Plus loan account, i.e., "honoring" of the check, four or more business days later under standard commercial practice.

Fourthly, defendant contends that 108(5)(b)(iii) is a more costly method, thereby automatically making the $100 multiple scheme legal. Defendant presents no relevant calculations to show the effect of this method of calculation and its conclusion is totally without support. An analysis of this section reveals to the contrary. Defendant's contention would only be true if actual overdrafts were exceeded by "not more than $5.00." Thus, whenever the $100 multiple practice would cause a balance of more than $5.00, it would be more costly than this alternative. This dovetails with Citibank's practice of only utilizing the $100 multiple scheme for overdrafts in excess of $5.00 (A47).

Not only is the factual basis of this contention without merit, but also the legal basis which relies on a misconstruction of the holding in Zachary v. Macy & Co., supra. Zachary relates to plaintiff's cross-appeal, and not to the $100 multiple device. It is analyzed at length in Point II, infra.

As a further defense, Citibank claims, after elaborate evaluation, that overcharges exacted from defendant (A6-12) are de minimus, to wit, 98¢. Defendant attempts to confuse the question of liability with the question of damages. It is irrelevant to a determination of the illegality of $100 multiple scheme. The District Court did not make any determination as to the amount of damages to the plaintiff. Decretal paragraph (5)(c) of the lower court's order (A72) expressly grants summary judgment "to plaintiff in such amount as shall be found to be due to him as damages, plus such penalties as may be found due. . .".

In any event, there are approximately 100,000 members of the plaintiff class*. If each class member is illegally charged $1 extra every two months, Citibank is exacting $600,000 per year of illegal income.** Citibank's argument would mean that mass illegalities in

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* Statement by defendant's counsel at oral argument before this court on defendant's application to stay class action determination, although this information was denied to plaintiff in response to interrogatories made by him which are presently the subject of a motion to compel answers pending before the district court.

** This does not include income derived from this income or from the forced deposits created.

individually small amounts would not be actionable. Similarly, it would logically mean that if the United States government brought an action for recovery of $200 million, defendant could urge dismissal of the action because only $1 per capita was involved. Defendant's position is utterly without merit.

Lastly, Citibank claims that it could have charged 25¢ per check for each check drawn on the account, rather than the 15¢ it now charges. Such a charge would in no way affect the method of calculation of finance charges under the statute, nor is what Citibank could have charged a relevant consideration. As a practical matter, such higher amount would not be feasible. Such charge is already 50% higher than Citibank's nearest competitor, Chase Manhattan Bank, which charges only 10¢ per check (Landau v. Chase Manhattan Bank, supra).

C. Additional Expense or Sacrifice

Not only is the $100 multiple practice on its face unconscionable because of the forced deposits and loans created and the attendant additional interest expense. The device clearly permits Citibank to garner additional profits because of its lending base being increased.

Commercial banks, as Citibank, have a unique ability. They can create "money". This ability is based upon loans given by the crediting of checking accounts. The amount of such loans which may

be extended is dependent upon the amount of "reserves" which defendant has to maintain with the Federal Reserve Board. Under present regulations, the bank must maintain "reserves" equal to 17% of its "net demand deposits" up to $5 million and 17 1/2% thereafter (12 C.F.R. Sec. 204.5(a)(2)(iii). Any credit balance in plaintiff's checking account is a "demand deposit" usable as the requisite "reserve". Thus, a source of new lending power is derived by the bank equal to almost 6 times the amount of demand deposits. This, of course, includes demand deposits artificially and coersively obtained from Checking Plus customers.

Thus, the reciprocal relationship between credit extension and the creation and maintenance of checking account balances derives from the manner in which "these two basic constituents of the bank process perpetuate themselves: deposit balances constitute the primary resource base for credit and the process of extending credit results in the creation of deposit balances in the form of check accounts." (58 Va. L. Rev. 1,63).

Citibank claims to the contrary. It states that a "$200 credit to plaintiff's account is a demand deposit <u>against which a reserve must be placed</u> and not a 'reserve' which might enable Citibank to generate additional loans." (Def.'s emphasis) (Br., p.17). It is true that a "reserve" must be placed against the $200 deposit.

However, this "reserve" would only be 17-17 1/2% of the $200 deposit, or $34-35. Consequently, the remaining balance of $165-166 would be available for new loans in approximately 6 times the remaining deposit balances, or $990-996. Of course, additional interest income is derived by Citibank from such loans. This additional interest income does not benefit plaintiff or the other checking account customers. They only have unnecessary "additional expense or sacrifice" in violation of 108(5)(f). The bank is thus in the enviable position, from its viewpoint, of deriving illegal interest charges from plaintiff and further interest income from increased lending operations made possible because of the forced deposits it created.

The foregoing amply demonstrates the unconscionability and patent unfairness of the $100 multiple practice.

POINT II

THE FAILURE TO DEDUCT PAYMENTS IN THE FORM OF DEPOSITS TO CHECKING ACCOUNTS FROM OUTSTANDING CHECKING PLUS LOANS IS AN ILLEGAL, UNCONSCIONABLE AND PREDATORY SCHEME

A. Illegality and Unconscionability

Plaintiff's cross-appeal relates to the practice of defendant

of not deducting payments, via checking account deposits, from the Checking Plus loan balances. In the same manner as the $100 multiple scheme, the advertising of defendant is geared to showing the convenience of the Checking Plus account. Customers naturally "assume that Checking Plus loans can be repaid as easily as they are increased - by a routine deposit in the account." (A57)* For example, a typical advertisement states:

> ". . . As you repay, the reserve builds up. So you can use it again and again." (A58)

Rather than deduct deposits to the checking account from outstanding Checking Plus loans, defendant continues to charge interest on the full outstanding principal, unreduced by the amount of the deposit. The method of reducing outstanding Checking Plus loans is limited to payments "to the Checking Plus account, 'accompanied by a properly completed payment ticket' (enclosed with the monthly Checking Plus Statement) or by any other properly completed form of notice of prepayment authorized by the bank. . ." (A68).

As found by the district court "it is possible for a customer

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* The check-credit plan of Chase Manhattan Bank, defendant's largest competitor, does not employ this device. Under the Chase Plan, payments, via deposits to the checking account, are automatically deducted from loan balances. The plan of Chemical Bank New York Trust Co. similarly deducts deposit payments, but only to the extent of the minimum payments due under the credit agreement. (Rothenberg v. Chemical Bank New York Trust Co., Civ.No. 74-600 (S.D.N.Y.).

to have a positive balance in his special checking account larger than the debt in his Checking Plus account and still pay interest on the entire debt". (A68).

It is undeniable that the failure to deduct deposit payments causes additional interest charges to be extracted from the plaintiff and other Citibank customers similarly situated. As stated by defendant, interest is computed "by multiplying the average of daily principal balances times the daily rate of .0333% and then multiplying the result by the number of days in the billing cycle." (A25). Thus, additional excessive interest charges are exacted equal to the amount of a deposit times the number of days it is not deducted from the outstanding principal in the Checking Plus loan account times the daily interest rate. For example, plaintiff's checking account statement shows a deposit of $125.00 on September 12, 1972 (A40). However, his Checking Plus statement for the period ending September 25, 1972 shows total payments of only $41.39 (A37) which payments did not include the $125 deposit.

The relevant Checking Plus loan agreement provision, which is buried in a sea of words (in a seventeen-line paragraph consisting of approximately 391 words in small print) is as follows:

> ". . . the deposits to the above-mentioned checking account will not be applied to pay or prepay any charges hereunder for loans, finance charges or late charges." (third paragraph thereof)(A35).

This completely one-sided provision disregards the statutory limitations. Plaintiff and other similarly situated customers could not obtain Checking Plus accounts except on the condition precedent that they agreed to this provision. There is no bargaining process. A customer can either "take it or leave it", as is usual with contracts of adhesion.

The Court below apparently did not consider 108(5)(b)(i) and its applicability to disregarding of deposits by defendant as a reduction of "unpaid principal amounts. . . outstanding". This subdivision requires computation of interest only on the "unpaid principal. . . outstanding", or, in this case, on the average daily principals. In a remedial statute of this type, the words "unpaid principal. . . outstanding", can only be reasonably construed to mean that amounts which have been paid via deposits to the checking account should be deducted from outstanding check overdraft loans. The plain statutory language prohibits the defendant's practice. It is submitted that the court below improperly held that disregarding deposit payments was sanctioned under 108(5).

The district court did examine 108(5)(d), at least subdivision (iii) thereof, and 108(5)(f), and found neither defendant's agreement nor practice violate either of these subdivisions. A failure to reduce "unpaid principal" by deposit payments, however, would violate

the intent of 108(5)(d) to foster early payment and thereby reduce interest charges to consumers. Both the defendant's agreement and practice had the contrary effect. Early payment would be retarded and higher interest costs would result from defendant's scheme.

Finally, 108(5)(f) cumulatively and conclusively shows that the statute would not countenance any scheme or device to subvert the remedial intent to limit interest charges, whether in the form of forced deposits,"or to do or refrain from doing any other act which would entail additional expense or sacrifice. . .". It is clear that disregarding deposit payments resulted in both an additional expense and a sacrifice. A forced deposit rather than a reduced loan entails additional interest expense on the unreduced principal amount of the loan which is no longer outstanding. A "sacrifice" results from additional profits derived by defendant because of the increased lending base created by the forced deposits.

B. Zachary v. Macy & Co.

The Zachary case, (39 A.D. 2d 116 (1st Dept. 1972) r'v'd and af'd in part, 31 N.Y. 2d 443 (1972) is relevant to defendant's failure to deduct deposit payment scheme.

In Zachary, retailers used what is known as "the previous balance" or "opening balance"method of computing finance charges in connection

with their charge account customers. Under this method, all partial payments and purchases made during the current billing cycle were disregarded for the purposes of computing finance charges. Finance charges were computed on the opening balance in an account, which was the closing balance of the prior billing cycle. Additionally, if full payment of amounts due were made, no finance charge at all would be imposed. (31 N.Y. 2d 443, 452). The system is based on a deferral of finance charges from the end of the prior billing cycle to the beginning of the current billing cycle.

The Zachary case, if properly understood, is dispositive of plaintiff's claim. All of the factors which that divided court considered controlling in holding the "previous balance" method legal, are not present herein. These crucial differences, both factually and legally, are enumerated below.

1. The statute at issue there required computation of finance charges on the "outstanding indebtedness from month to month". The Appellate Division (39 A.D. 2d, 116), by a divided court, held that the "plain words" of the statute were violated by the "previous balance" method, as "outstanding indebtedness" did not include sums which were paid. The Court of Appeals reversed, also by a divided court. It recognized that: (1) ". . . there was something distinctly

artificial about the method"; (451) (2) that "the procedure is simply one of deferred billing, but with a 'kick'"., i.e., partial payments are disregarded (p.452); (3) that "there seems little logic to commend its use." (p.453).

2. Despite these adverse consequences for consumers, the Court (5-2) held that the method was legal based on the following factors:

(a) The consumer enjoys one monthly billing cycle plus, depending on the date of the purchase, to avoid a finance charge and without worry of further inflating that charge by current purchases. . ."(p.453).

(b) The "quid pro quo for excepting current purchases" by the retailer is the disregarding of current payments.

(c) The deferral of finance charges to periods after the month of purchase or even in the subsequent month, if full payment were made during that cycle, was the systems "attraction" and "explains its overall success". (p.453).

(d) The "previous balance" method was used by virtually all retailers prior to enactment of the relevant statute involved there. (pp.454 & 460).

(e) There was a difference between interest on loans and finance charges on the sale of goods which constitute a "time-price differential". (p.457).

(f) The words "outstanding indebtedness" in the statute were de-emphasized and the modifying words "from month to month" were stressed. The court under all the "circumstances" of the "previous balance" system held that payments could be disregarded as the "month to month" phase:

> "Merely requires that finance charges be computed at consistent monthly intervals on the customers outstanding balance at the time.. Since the previous balance provides for the consistent computation of finance charges on the customers outstanding indebtedness on the last day in the prior billing period - carried forward as the outstanding indebtedness at the beginning of the current period - it complies with 413(3)." (p.461).

3. The two dissenters in Zachary, termed it:

> ". . . incredible that the New York legislature would intentionally have sanctioned this adverse effect on consumers. Its intention, indeed, must be deemed to have been favorable to New York consumers and the language it used is consistent with that intention". (p.463).

The dissenting opinion has been following in Grigg v. Robinson Furniture Company, C.C.H. Cons. Credit Guide, para. 98, 848 (Mich. Cir. Ct., 1974). Other jurisdictions have also declared the previous balance system illegal. State v. J.C. Penney & Co., 48 Wisc. 2d 125 (1970); Rollinger v. J.C. Penney, 192 N.W. 2d 699 (S.D. 1971).

4. The circumstances herein, however, with respect to disregarding deposit payments by Citibank customers are totally different

as to each and every factor found crucial in Zachary.

(a) The statute here requires payment on "unpaid principal. . . outstanding" not an "outstanding indebtedness". The word "principal" has a significantly narrower scope than the ambiguous word "indebtedness". See: Madison Personal Loan v. Parker, 124 F.2d 143, 146 (2d Cir. 1941).

(b) Checking Plus customers pay interest starting from the date of presentment of a check, i.e.even before credit is extended by the "honoring" of a check.

(c) Interest charges are payable in all circumstances. There is no exception for current purchases or full payment, as in the "previous balance" system.

(d) The "quid pro quo" of disregarding current purchases and current payments is not present.

(e) The crucial "deferral" feature of the previous balance system is not present.

(f) The legislative history is entirely different. The previous balance method had been commonly used by retailers for many years prior to the enactment of the controlling statute. The defendant, on the other hand, has only used its system since 1966. Its biggest competitor, Chase Manhattan Bank, only since 1967. Not one iota of evidence has been presented by defendant, or its amicus, that this

scheme was commonly employed by banks prior to 1960, when 108(5) was enacted.

(g) Interest charges on loans by a bank are involved and not a "time-price differential" by retailers on the sale of goods.

(h) Computing interest at consistent daily intervals gives defendant an opportunity to reflect deposit payments as they are received each day. Where a consistent monthly system such as the "previous balance" method is used, however, there is no such opportunity, as the opening balance upon which finance charges are computed represents the closing balance of the prior billing cycle.

(i) The statute in Zachary did not include provisions comparable to 108(5)(d) and (f) which clearly show the statutory intent to prevent schemes to evade the usury laws.

CONCLUSION

For all of the foregoing reasons, it is respectfully requested that:

(1) The portion of the order appealed from by defendant granting summary judgment and an injunction in favor of plaintiff, with respect to the $100 multiple scheme, as set forth in decretal paragraph (5) of said order, be affirmed.

(2) The portion of the order cross-appealed from by plaintiff with respect to denying plaintiff's cross-motion for summary judgment and an injunction, as set forth in decretal paragraph (4) of said order, be reversed, and summary judgment and an injunction be granted to plaintiff.

(3) If the defendant's practices are illegal, defendant should be enjoined from further using such practices with respect to all Checking Plus customers.

(4) Such other and further relief as to this Court may seem just and proper.

Dated: New York, N. Y.
May 9, 1974

Respectfully submitted,

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MAY [illegible] 1974

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ATTORNEYS FOR Deft. Appellant

The Undersigned hereby certifies that a copy of the within brief was mailed to John Leferovich, Jr., Esqs., attorney for amicus New York State Bankers Association, at 485 Lexington Avenue, New York, N. Y. 10017, on May 9, 1974.

SHELDON V. BURMAN